

**PUBLIC UTILITIES COMMISSION**

505 VAN NESS AVENUE  
SAN FRANCISCO, CA 94102-3298



November 7, 2002

Alternate to Agenda ID# 1057

**TO: PARTIES OF RECORD IN RULEMAKING 01-12-009**

Enclosed is the Alternate Draft Decision of Commissioner Loretta Lynch to the Draft Decision of Commissioner Geoffrey Brown previously mailed to you.

When the Commission acts on this agenda item, it may adopt all or part of it as written, amend or modify it, or set aside and prepare its own decision. Only when the Commission acts does the decision become binding on the parties.

As set forth in Rule 77.6(d), parties to the proceeding may file opening comments on the enclosed alternate at least seven days before the Commission meeting or no later than November 14, 2002. Reply comments are due no later than November 18, 2002. An original and four copies of the comments and reply comments with a certificate of service shall be filed with the Commission's Docket Office and copies shall be served on all parties on the same day of filing. The Commissioners and ALJ shall be served separately by overnight service. Please also provide an electronic copy of the comments to Tom Long at [tjl@cpuc.ca.gov](mailto:tjl@cpuc.ca.gov).

/s/ CAROL A. BROWN  
Carol Brown, Interim Chief  
Administrative Law Judge

Decision **ALTERNATE DRAFT DECISION OF COMMISSIONER LYNCH**  
**(Mailed 11/7/02)**

**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

Order Instituting Rulemaking on the  
Commission's Own Motion to Evaluate Existing  
Practices and Policies for Processing Offset Rate  
Increases and Balancing Accounts in the Water  
Industry to Decide Whether New Processes are  
Needed.

Rulemaking 01-12-009  
(Filed December 11, 2001)

**INTERIM DECISION REVISING THE PROCEDURES FOR RECOVERY OF  
BALANCING ACCOUNTS EXISTING PRIOR TO NOVEMBER 29, 2001**

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**INTERIM DECISION REVISING THE PROCEDURES FOR RECOVERY OF  
BALANCING ACCOUNTS EXISTING PRIOR TO NOVEMBER 29, 2001****I. Summary**

In this interim decision applicable only to Class A water utilities, we revise the existing procedures for recovery of under collections and over collections in balancing accounts existing prior to November 29, 2001 as follows: (1) If a utility is within its rate case cycle and is not over earning, the utility shall recover its balancing account subject to reasonableness review; and (2) If a utility is either within or outside of its rate case cycle and is over earning, the utility's recovery of expenses from the balancing accounts will be reduced by the amount of the over earning, again subject to reasonableness review. The utility shall remove the amount of the over earning from the balancing account and shall amortize it below the line. Utilities shall use the existing pro forma means test to evaluate earnings of the first and second test year revenues only, and for subsequent years shall use the recorded rate of return means test.

We find that balancing accounts were not intended to allow utilities to gain reimbursement of unanticipated expenses when the utilities are earning in excess of their authorized rate of return. Instead, balancing accounts were intended to prevent financial hardship resulting from unanticipated expenses. If we continue to permit full balancing account recovery for utilities with rates that produce earnings above authorized levels, we will essentially be requiring customers to pay twice for the unanticipated expenses – once via the rates that are already sufficient to produce excess earnings even with the unanticipated expenses, and another time via full balancing account recovery. This is not the result that was intended when balancing accounts were instituted.

**II. The Order Instituting Rulemaking****A. Pub. Util. Code § 792.5**

The Commission may permit a utility to change its rates to account for a change in costs (sometimes called an offsettable expense change, or an offset.) Upon receiving authorization to pass through the costs, the utility shall maintain a balancing account under Pub. Util. Code § 792.5,<sup>1</sup> reflecting the difference between actual costs the utility incurs and the revenue collected through the expense offset rate increase or decrease.<sup>2</sup> The Commission has traditionally authorized offset rate increases and attendant balancing account treatment to protect utilities from significant unforeseen expenses over which the utility has no control, such as the unforeseen increased expenses of purchased power, purchased water and pump tax.

**B. The Controversy**

In the summer of 2001, several water utilities filed advice letters seeking offset rate increases to compensate for recent increases in the costs of purchased power which were not anticipated in the utilities' last general rate case. The Office of Ratepayer Advocates (ORA) protested the request to raise the rates of

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<sup>1</sup> Pub. Util. Code § 792.5 speaks in terms of a "reserve account." (See the text of the statute in the footnote below.) A reserve account that has both revenues and expenses booked to it is also called a balancing account.

<sup>2</sup> Pub. Util. Code § 792.5 states: "Whenever the commission authorizes any change in rates reflecting and passing through to customers specific changes in costs, except rates set for common carriers, the commission shall require as a condition of such order that the public utility establish and maintain a reserve account reflecting the balance, whether positive or negative, between the related costs and revenues, and the commission shall take into account by appropriate adjustment or other action any positive or negative balance remaining in any such reserve account at the time of any subsequent rate adjustment."

20 districts of California Water Service Company (CWS), arguing that: (1) the Commission should not authorize offset rate increases for CWS districts because the utility is “over earning,” that is, it is earning a rate of return greater than that authorized in the utility’s last general rate case; and (2) the Commission should not permit water districts which are outside their rate case cycle to utilize balancing account treatment.<sup>3</sup>

In response, the Commission’s Water Division drafted Resolution W-4294, dated November 29, 2001, which researches the history, rationale, and procedures for implementing offset rate relief and related balancing accounts. The Water Division staff concluded that: (1) ORA’s protest raises serious issues of first impression warranting full Commission consideration; and (2) the Commission should consider ORA’s recommendations on an industry-wide basis. The Commission agreed with staff’s recommendations and issued this OIR.

### **C. The Scope of the OIR and this Decision**

In the OIR, we evaluate existing practices and policies for processing offset rate increases and balancing accounts for water utilities and determine if new procedures or policies are needed. The OIR identifies the Class A and B water and sewer system utilities and ORA as respondents to written inquiries, and states that other interested parties and other water and sewer system utilities are not required to, but can, participate.

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<sup>3</sup> According to ORA, districts that failed to apply for a general rate case when they had an opportunity to do so, either according to the Rate Case Plan adopted in Decision (D.) 90-08-045, 37 CPUC2d 175, or by other Commission decision, would be outside of their rate case cycle.

The OIR set forth issues to be addressed in an interim and a final decision. This interim decision addresses the following issues, the resolution of which only applies to Class A water and sewer utilities:<sup>4</sup>

“The existing procedure for recovery from balancing accounts is as follows: (1) Utilities, at their option, may request a surcharge once under collections reach 2 percent; (2) Otherwise, balancing account review and recovery of remaining balances are processed at the time of the district’s next GRC.

“1. Should the Commission revise its existing procedures for recovery of under collections or over collections in balancing accounts that existed prior to, and were suspended on November 29, 2001? Why or why not?

“2. If your answer to Part II, Question Number 1 is yes, what specific procedures should be implemented:

“(a) for districts that are within their rate case cycle and are not over earning?

“(b) for districts that are within their rate case cycle and are over earning on an actual or on a pro-forma basis?

“(c) for districts that have stale adopted quantities because they are outside their rate case cycle.””

### **III. Procedural Background**

We received comments or replies on the interim issues from ORA as well as the following utilities: Alisal Water Corporation, Apple Valley Ranchos Water Company, California-American Water Company (CalAm), CWS, California Water Association, Del Oro Water Company, East Pasadena Water Company, Great Oaks Water Company, Park Water Company, San Gabriel Valley Water

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<sup>4</sup> This interim decision only applies to Class A water and sewer utilities because Class B water and sewer utilities use a recorded earnings test.

Company, San Jose Water Company (San Jose), Southern California Water Agency (SoCal Water), Suburban Water Systems (Suburban) and Valencia Water Company (Valencia).

The March 11, 2002 Scoping Memo, as amended, confirmed the categorization of the proceeding as quasi-legislative, that hearings were not necessary, and that a draft interim decision would issue no later than September 13, 2002.

Some commenting parties believed that hearings were necessary prior to the Commission adopting an interim decision or that other issues should be included within the scope of this proceeding. The California Water Association believed that issues of possible increased risk from the OIR's proposed changes, and how various risks affect a utility's rate of return, should be considered in hearings. The Scoping Memo rejected the need for hearings, reasoning that "[r]e-adjusting a utility's specific rate of return is not within the scope of this industry-wide proceeding. The appropriate rate of return is an issue for the utilities' general rate cases. Furthermore, the question of how various risks affect a utility's rate of return involves an inquiry into all relevant circumstances, not just one specific factor. Again, the appropriate forum for such inquiry is a utility's general rate case, or other appropriate proceeding the Commission may designate in the future."<sup>5</sup>

The Scoping Memo also rejected San Jose Water Company's request for hearings because the company believed that consideration of water company earnings data during a selected five-year period is contrary to the Commission's

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<sup>5</sup> March 11 Scoping Memo at pp. 5-6.



ratemaking methodologies employed to set water rates in the first place. The Scoping Memo reasoned that the fact that the OIR sought information on earnings over a five-year period does not mean the Commission will employ any particular methodology or time period to establish eligibility for recovery of balancing accounts. Moreover, San Jose did not state any disputed issues of material fact for which hearings would be necessary.<sup>6</sup>

CWS requested hearings and workshops to explore the causes of over earning, arguing that over earning is not caused by the balancing accounts. The Scoping Memo explained that the cause of over-earning is not relevant to the OIR because the OIR does not maintain that balancing accounts cause the over earning. Rather, the OIR asks whether recovery of the balancing accounts should be eliminated or reduced in certain circumstances when the utility is over earning. The Scoping Memo also explained that, under the proposals being considered, the utilities would keep earnings above the authorized rate of return that are not attributable to balancing account recovery.

We affirm the rulings set forth in the scoping memo.

The Scoping Memo authorized workshops on one technical issue raised by San Gabriel Water Company, that is, with respect to the weather adjusted pro forma return earnings test, what is the proper calculation of the expense component of the means test. The results of this workshop are discussed more fully below.

The California Water Association, Great Oaks Water Company, and SoCal Water requested oral argument pursuant to Rule 8(d) of the Commission's Rules

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<sup>6</sup> March 11 Scoping Memo at p. 7.

of Practice and Procedure. The Commission held oral argument on September 20, 2002, including, but not limited to, a draft decision issued before the oral argument occurred.

#### **IV. Resolution W-4294**

Before reaching its determination that the Commission should institute this OIR, Resolution W-4294 presented a detailed and useful background of the history of balancing accounts, within and outside the water industry, which we summarize here.

##### **A. Balancing Accounts Outside the Water Industry: The Edison Case**

Because of the steep increase in fuel prices in the early 1970s, the Commission authorized ratemaking adjustment mechanisms to protect utilities from the financial impact of substantial unforeseen expenses beyond the utilities' management and control. One such mechanism, the fuel cost adjustment clause (fuel clause), provided utilities with an expedited method (outside of frequent general rate cases) to recover expenses related to rapid changes in fossil fuel costs, to ensure continued utility operations, and to enhance their position in the financial community.

By 1975, it became clear that the fuel clause was producing distorted results. Instead of reimbursing the utilities for their actual fuel costs, the clause produced a windfall for the utilities that bore no relation to actual expenses. For example, between May 1972 and December 1974, Southern California Edison Company (Edison) repeatedly invoked the clause and raised rates no less than 12 times. In 1974, Edison had accumulated an overcollection of \$122.5 million, representing 56% of Edison's system-wide net income. In response to this problem, the Commission modified the fuel clause to insure that utilities did not

reap this unanticipated windfall at ratepayer's expense. The modification was a balancing account entitled the energy cost adjustment clause (ECAC). The Commission also required Edison to return to ratepayers by a billing credit the substantial over collections which the fuel clause generated.

In the Edison case,<sup>7</sup> the California Supreme Court upheld the Commission's decision refunding the over collections and establishing the ECAC, explaining that the Commission effectively corrected the distorted results of the old fuel clause by relying on actual fuel expenses from all sources incurred during a prior period rather than a forecast. The utility was required to maintain a monthly balancing account into which it would enter the amount by which its actual energy cost for the month was greater or less than the revenue generated by the clause, and on each occasion the clause was invoked, the billing factor would be adjusted so as to bring the balance of the account to zero.

Edison argued that it was entitled to keep the large overcollections generated by the old fuel clause because its actual rate of return averaged less than that authorized by the Commission. The Court disagreed, explaining that the utility is entitled only to the opportunity to earn a reasonable return on its investment, and that the law does not ensure it will in fact earn the authorized rate of return, or any net revenues. (Edison case, 20 Cal.3d at 821, n. 8.)

The Supreme Court also rejected Edison's argument that the Commission action was prohibited because it subjected Edison to retroactive ratemaking, explaining that the charges arising from the fuel clause were not the product of general ratemaking:

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<sup>7</sup> Southern California Edison Company v. Public Utilities Commission, 20 Cal.3d 813.

“Because the increased charges thus imposed were not the products of ratemaking, they were not rendered inviolable by the rule against *retroactive* ratemaking. To put it another way, the commission’s decision to further adjust those rates so as to compensate for substantial past overcollections may well be retroactive in effect, but it is not retroactive *ratemaking*.” (Edison case, 20 Cal.3d at 830.)

Finally, Edison argued that the Commission’s abrupt change from the old fuel clause’s average-year forecast method to the ECAC recorded method unreasonably disrupted the weather-normalized process by which the old clause, given enough time, would have balanced over and under collections. The Court noted that Edison therefore had no expectation of benefiting financially from the fuel clause, and should not be disadvantaged by the requirement to return overcollections to customers over a three-year period.

#### **B. The Operation of Water Balancing Accounts**

Applying an earnings test to balancing accounts is not new. The Commission allowed offsets for purchased water and power expense changes for Class A water utilities as early as 1974,<sup>8</sup> and for pump tax as early as 1972.<sup>9</sup> The advice letter offsets filed in the 1970s ranged from purchased power, purchased water and pump taxes, to employee labor and benefits and ad valorem and

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<sup>8</sup> See Resolution W-1550, April 30, 1974, Southern California Water Company Advice Letter 432-W to offset changes in purchase power (electricity and natural gas).

<sup>9</sup> See Commission memorandum dated May 24, 1972 regarding California Water Service Company Advice Letter 390 to offset changes in pump tax.

franchise taxes. Utilities filed 17 such offsets between 1972 and 1977. In each case, the increase was subject to an earnings test.<sup>10</sup>

In 1977, the Commission first established rules to address changes in water utilities' offsettable expenses. The 1977 policy described the advice letter offset program for purchased power, purchased water, and pump taxes as similar in concept to the ECAC in that the offset program allows a utility to recover cost increases that are generally beyond their immediate control. This policy required that in order to be eligible for the offset, the utility's rate of return should not exceed that last authorized by the Commission, and the amount of the offset should not exceed the revenue increase.<sup>11</sup>

In 1978, the Commission approved procedures for maintaining balancing accounts.<sup>12</sup> The 1978 procedures did not include a test to determine if the requested offset would cause the utility to exceed its authorized rate of return. However, for the past several years, Commission staff has continued to apply a weather normalized (pro forma) earnings test to determine if the requested offset will cause the utility to exceed its authorized rate of return.<sup>13</sup> When staff

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<sup>10</sup> The language of the resolutions does not indicate whether this was a recorded or a pro-forma earnings test. In either case, since there was no over earning under either test, no disallowances were required.

<sup>11</sup> Memorandum to the Commission from B.A. Davis, Director, Operation Division, Subject: Major Water Utilities Regulatory Policy, dated June 21, 1977, at p. 1. Approved at the June 28, 1977 Commission conference.

<sup>12</sup> Procedure for Maintenance of Balancing Accounts for Water Utilities, approved on June 6, 1978.

<sup>13</sup> The weather normalized (pro forma) earnings test calculates the rate of return by using (1) the revenues calculated by adding the actual commercial sales and actual number of residential customers times the already weather normalized number of sales

*Footnote continued on next page*

identifies such over earning, they delay but do not deny the requested offset rate increase or recovery of the balancing account until the earnings test demonstrates the utility would no longer be over earning.

The 1978 balancing account policy for Class A and B water and sewer utilities required that multi-district utilities maintain separate balancing accounts for each district and that each district keep three separate balancing accounts for (1) water production cost offsets, including purchased water and purchased power; (2) ad valorem tax offsets; and (3) all other types of offsets. The balancing account balances were to be amortized at the time of a general rate case; however, the availability of balancing accounts to record the over and undercollection of offsettable expenses is continuous. For the most part, the 1978 policies are in place today.

The Commission revised the balancing account procedures in 1983, and clarified that water and sewer utilities should record only the incremental change in cost increases incurred and revenues received since the utility's general rate case or last offset rate increase. The 1983 revisions also expressed concern about the use of quantities adopted in a general rate case when the rate case decision is older than five years, stating that these cases would be handled on a case-by-case basis.

In 1994, the Commission issued D.94-06-033, 55 CPUC2d 158 in its investigation into the financial and operational risks of regulated water utilities (the Risk OII). This decision addressed some balancing account issues for

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per customer adopted in the last general rate case, minus (2) the expenses authorized in the last general rate case adjusted by the actual number of customers and any approved offsets.

Class A water utilities. This decision considered but rejected a utility proposal for a program of complete revenue protection using a broad memorandum account, reasoning that the majority of water quality costs could be forecast with reasonable accuracy and included in a general rate case application. However, it permitted water utilities to seek authority in a general rate case or by application to add other specific water quality expenses to the Water Quality Memorandum Account, provided the costs were:

“unforeseen and therefore were not included in the utility’s last general rate case, that the costs will be incurred prior to the utility’s next scheduled rate case (or otherwise cannot be estimated accurately for inclusion in a current rate case), and that the expenses are beyond the control of the utility.”  
(55 CPUC2d at 191.)

### **C. The Rate Case Plan for Water Utilities**

In 1990, the Commission adopted a rate case plan for Class A water utilities. (See D.90-08-045, 37 CPUC2d 175.) Under the rate case plan, each utility is allocated a time for filing its general rate case, generally once every three years either in January or July. The rate case plan for water utilities, like a similar plan for energy utilities, establishes a comprehensive schedule for processing a general rate case, but does not require water utilities to file regularly for general rate cases.

## **V. Should the Commission Revise Existing Procedures for Recovery of Under Collections and Over Collections in Balancing Accounts Existing Prior to November 29, 2001?**

### **A. Parties’ Positions**

Many Class A and B water utilities and ORA responded to the interim issues. All the water utilities except for Valencia and Del Oro, believe that the

existing procedures should not be changed. Valencia argues for procedures that are less restrictive than the existing procedures and Del Oro did not set forth how it believes the procedures should be changed.

ORA believes that the procedures should be changed to better conform to the original purpose of the balancing accounts, which is to afford water utilities within their rate case cycle an opportunity to recover unanticipated increases in electricity costs occurring between general rate cases, thus preventing financial injury.

In order to conform the operation of the balancing accounts to their original purpose, ORA recommends that balancing account recovery should be capped for utilities within their rate case cycle which are not over earning, so that these utilities would be able to recover the amounts in the balancing accounts up to their rate of return. The remainder of the account would be disallowed.

If a utility is within its rate case cycle and is over earning according to a recorded rate of return means test, ORA believes that it should not be able to recover the balancing account. ORA believes that use of a recorded, rather than a pro forma (weather normalized) means test is appropriate for balancing accounts because, according to ORA, a balancing account recovers dollar-for-dollar expenses. If a utility is outside of its rate case cycle, ORA recommends that it should not be eligible for balancing account treatment until it submits a general rate case application and the Commission establishes new quantities. ORA believes that utilities that have “stale” adopted quantities from old general rate cases have been over earning for many years, and that the procedures should be revised to remedy this problem.

Many utilities have specific objections to revising the existing balancing account procedures. For example, Suburban, SoCal Water, and Valencia believe



that the proposals to revise balancing account treatment are one-sided because the utility is required to refund over collections when it is under earning, suggesting that it is unfair to deny a utility recovery when it is over earning. Many utilities, including SoCal Water and CWS, believe that a change in procedure will cause additional risk, and that this OIR should address the added risk and impact on the affected utilities' cost of capital by changing balancing account recovery policy. San Jose, CWS, and Suburban believe the utilities accumulated the accounts according to well-established procedure; thus, disallowing the accounts would violate the regulatory compact. Other utilities argue that the proposed revisions will deny the utility the right to a fair return on investment, constitute retroactive ratemaking, and reverse an earlier Commission decision which did not require the water utilities to file general rate cases every three years.

## **B. Discussion**

### **1. Policy Reasons Underlying the Need to Revise Our Procedures**

Like the Edison case, we believe that a revision to our existing procedures are necessary here in order to effectively correct distorted results. The existing procedures for recovery of under and over collections in balancing accounts, which we suspended as of November 29, 2001, were originally established for the utilities to recover unanticipated increases in electricity costs<sup>14</sup> between general rate cases, without the need to file an additional rate case application. The procedures also served the purpose of protecting shareholders

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<sup>14</sup> The Commission expanded this balancing account mechanism to include two additional types of unanticipated expenses: pump taxes and water acquisition expenses.

from having to finance large unanticipated expenses until the next general rate case.

The existing procedures become problematic when they have the practical and widespread effect of enhancing many utilities' earnings above the Commission-authorized rates of return. It is unreasonable to permit the utilities to pass through to ratepayers the dollar-for-dollar costs accumulated in their balancing accounts when these same utilities are earning more than their authorized rate of return, particularly when their ratepayers are also experiencing the same increased electrical costs in their own homes. To permit such recovery would be to grant the utilities an unanticipated windfall at ratepayer expense.

This problem is not an isolated incident. This OIR required the utilities to state during which of the last five years they were over earning on an actual and weather normalized, or pro forma basis. On an actual basis, over earnings exceeded undercollected balancing accounts by \$15,771,000, with over earnings listed as a little over \$42 million and undercollected balancing accounts listed as about \$26.5 million.

On a weather normalized basis, over earnings were about \$15,826,000. When viewing total utility over earnings for 1997 through 2000, CWS reported its pro forma over earnings were \$7,174,700. For that same period, Valencia stated its pro forma over earnings were \$5,798,600. For Valencia, this means that its pro forma earnings exceeded its adopted revenues by 16.8% in 1999 and by 21.6% in 2000. For examples of individual districts, the pro forma earnings of the King City Division of CWS exceeded its adopted revenues by 45.1% in 1998 and for the East Los Angeles Division, the pro forma earnings exceeded its adopted revenues by 14.3% in 2001. (See Appendix A for a list of

utility over earnings and undercollected balancing account totals for 1996-2000 on an actual and pro-forma basis.)

Another related problem with the procedure occurs when a utility fails to file general rate case applications every three years, yet continues to seek balancing account treatment beyond the rate case cycle, thus depriving the Commission of scrutiny over the assumptions used to determine the rate structure. When these assumptions become stale, the rate structure becomes skewed. For example, in the general rate case, utilities base their purchased power expenses on a certain system configuration that, due to the passage of time, may no longer exist because it has been replaced with a more efficient system. By using the stale assumptions, these efficiencies are not captured for ratepayers.

The Edison case is consistent with today's decision to revise the balancing account procedures for accounts existing prior to November 29, 2001. In the Edison case, the California Supreme Court permitted the Commission to change the procedures for recovery of the fuel clause when the existing procedures produced distorted results and an unanticipated windfall for Edison. The Court so held, even though the Commission did not modify the fuel clause on a prospective basis only, but required Edison to amortize, by 36 months of billing credit to its customers, the substantial over collections generated by operation of the fuel clause. Here, we do not require that the utilities refund any amounts to customers; we merely revise the existing procedures so that customers do not finance utility revenues in excess of the utility's authorized rate of return for balancing account expenses.

## **2. Responses to the Utilities' Objections**

The utilities argue that capping their recovery of the balancing accounts so that a utility can achieve, but not exceed, its last authorized rate of return is unreasonable or illegal for a number of reasons. The utilities argue that this proposal: (1) is unfairly “one-sided” in that the utility is required to refund over collections when it is under earning; (2) increases utility risk; (3) violates the regulatory compact; (4) denies the utility the right to earn a fair return on investment; (5) constitutes retroactive ratemaking; and (6) reverses an earlier Commission decision which did not require the water utilities to file general rate cases every three years. We disagree, as we explain below.

The proposal is not unfairly “one-sided” as claimed. The original purpose of these balancing accounts was to allow the utilities to recover fluctuations in unanticipated expenses within the normal rate case cycle to prevent financial injury. A utility that exceeds its authorized rate of return is not in financial peril; thus, there is no need for recovery of the balancing accounts in excess of its authorized rate of return.

The utilities also argue that capping recovery of the balancing accounts can increase risk. The issue of how various risks affect a utility's rate of return involves an inquiry into all relevant circumstances, not just one specific factor. As ruled in the scoping memo, and affirmed by today's decision, the readjustment of a utility's specific rate of return is not within the scope of this industry-wide proceeding. The appropriate forum for such a utility-specific inquiry is a utility's general rate case or other appropriate proceeding the Commission may designate in the future.

We disagree with the utilities that the revised procedure violates the regulatory compact because the monies were booked pursuant to a longstanding

procedure with an expectation of recovery pursuant to this procedure. We note, first, that one utility, CalAm, believed the “longstanding procedure” capped recovery at the utility’s authorized rate of return, and operated its balancing accounts accordingly. Second, and more fundamental, similar to the Edison case discussed above, the Commission has the discretion to modify the existing procedure when it is producing unintended results. As previously noted, the clear intent of balancing accounts was to prevent financial injury resulting from unanticipated expenses. The intent was not to reimburse utilities for unanticipated expenses regardless of their level of earnings. If utilities developed an expectation that balancing accounts could and should be used to recover expenses even when the utilities are earning in excess of their authorized rates of return, such expectation was unreasonable.

The proposal will not deny the utility a right to earn a fair rate of return on investment. In the Edison case, the California Supreme Court upheld the Commission’s modification of the fuel cost adjustment clause although Edison’s actual rate of return averaged less than that authorized by the Commission. Here, the revised procedures will permit the utility to earn at least up to its authorized rate of return, and even more than the authorized rate of return through any means other than the collection of these balancing accounts.

We disagree that the revised procedure constitutes retroactive ratemaking. In the Edison case, the Supreme Court rejected Edison’s argument that the Commission action modifying the fuel clause constituted retroactive ratemaking, reasoning that the increased charges imposed were not the product of ratemaking. (20 Cal.3d at 830.) The Court further held that the prohibition of retroactive ratemaking should not be used as a device to “fetter the commission in the exercise of its lawful discretion.” (20 Cal.3d at 816.)

“...[W]e construed Public Utilities Code section 728 to vest the commission with power to fix rates prospectively only. But we did not require that each and every act of the commission operate solely in futuro; our decision was limited to the act of promulgating ‘general rates.’” (*Id.*)

Similarly, in this case, although our action may not operate “solely in futuro,” we are not engaged in ratemaking as defined in the Edison case; thus, the doctrine of retroactive ratemaking is inapplicable.

### **3. Adopted Revised Procedures**

This section addresses the revised procedures that we implement for balancing account collection for the accounts existing prior to November 29, 2001. Because of these procedures’ limitations, they are applicable only to Class A water utilities because Class B, C, and D utilities use recorded earnings in their computations, and Resolution W-4294 directs the Water Division to continue to recommend approval of advice letter offset requests by Class B, C, and D water utilities that are not over earning on an actual basis for accounts in existence prior to November 29, 2001.

The OIR said we would address procedures for the following scenarios: (1) districts that are within their rate case cycles and are not over earning; (2) districts that are within their rate case cycles and are over earning on an actual or pro forma basis; and (3) districts that are outside of their rate case cycles. The following is an overview of the principles underlying the adopted procedures and a summary of the adopted procedures. The detailed procedures

we adopt today are set forth in Appendix B, and Appendix C provides an example of the application of these procedures.<sup>15</sup>

**a) Principles Common to All Scenarios**

**(1) Offsettable Expense**

To qualify as an offsettable expense for balancing account treatment, the Commission must have approved the expense for balancing account tracking in a decision. A utility's advice letter requesting an offset rate increase should include the citation to the decision or other Commission document approving tracking of each type of expense requested, except for purchased power, purchased water and pump tax expenses.

The earnings data the utilities filed in response to the OIR indicated that almost half of the balancing account entries do not concern purchase power, water or pump tax, and many contain multiple unexplained expense items (i.e., miscellaneous.) Thus, it is necessary for the utilities to better identify and justify the entries made in these balancing accounts.

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<sup>15</sup> We anticipate a second decision in this rulemaking addressing the adopted procedures for balancing accounts existing after November 29, 2001.

**(2) Offset Revenues**

If the Commission authorized a change in base rates to offset the expense, the resulting offset revenues must be booked to the same balancing account. These revenues consist of the authorized incremental rate change multiplied by the recorded amount of water sold (for changes to the commodity charge) or by the number of meter equivalent customers (for changes to the service charge).

**(3) Tracking Offsettable Expense and Revenues in Balancing Accounts**

The earnings information the utilities provided in response to this OIR demonstrated that there is a lack of consistent tracking methods in the balancing accounts. We require that the utility book each authorized offsettable expense and corresponding offset revenue (if any) to its own balancing account. Each district of a multi-district utility shall keep its own set of balancing accounts. Balancing account balances existing after June 22, 1994, shall earn interest at the Commission-authorized rate.

**(4) Timing of Filings**

Resolution W-4294 directed the Commission's Water Division to continue the established practice of rejecting without prejudice Class A water utilities' advice letters requesting offset rate increases that are within their rate case cycle and are over earning on a pro forma, or weather normalized basis. It also required the Water Division to reject without prejudice all utility advice letter requests for offsets if the Class A utility has elected to forego a timely general rate case and is outside of its rate case cycle.



Utilities that are in the above two situations have 90 days from the effective date of this decision to file advice letters requesting offsets pursuant to the policies and procedures set forth in this decision.<sup>16</sup>

**(5) Means Test**

Two tests are available in order to determine if a utility is earning an amount greater than its authorized rate of return. The first is a pro forma, or weather normalized means test which we described above. The Commission also uses this test to determine the utility's eligibility for a second year and attrition year increase in its general rate case cycle. The second test is the recorded rate of return means test, which uses actual, as opposed to weather normalized figures in the computation.

**b) Districts Within Their Rate Case Cycle  
Which Are Not Over Earning**

If a district is within its rate case cycle and is not over earning, the problems associated with over earning do not exist. In this case, the utility shall recover its balancing account, subject to reasonableness review.

**c) Districts Either Within or Outside of Their  
Rate Case Cycle Which Are Over Earning**

If a utility is within its rate case cycle and is over earning, the utility's recovery of expenses from the balancing accounts will be reduced by the amount of the over earning, subject to reasonableness review. The utility shall remove the amount of the over earning from the balancing account and shall amortize it below the line.

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<sup>16</sup> This requirement extends the filing deadline for Class A utilities which are outside of their rate case cycle, as set forth in Resolution W-4294, Ordering paragraph 11, p. 20.

The pro forma means test shall be used to evaluate earnings for revenue received for the first and second test year, and the recorded rate of return means test shall be used in subsequent years. If a utility is outside of the rate case cycle but is not over earning according to the above tests, then it shall recover as set forth in Section V.B.3.b above. Although ORA recommends that we use a recorded earnings, rather than the pro forma means test, we adopt the pro forma test for revenues received in the first and second test years because the pro forma test analyzes revenues on a ratemaking (future year estimated) basis and is therefore more appropriate and consistent to apply to the test years.

The workshop on the proper calculation of the expense component of the means test demonstrated that applying the pro forma test to non-test years produces distorted results. (See April 22, 2002 Water Division Workshop Report filed in this OIR.). Therefore, we adopt the recorded rate of return means test to evaluate the attrition year.

ORA believes that utilities outside of their rate case cycle should be ineligible for balancing account treatment until they submit a general rate case application and new quantities are established. We reject this proposal for balancing accounts existing prior to November 29, 2001, in order to achieve closure on these accounts. However, we will evaluate ORA's and others' proposals in a subsequent decision addressing rules for balancing accounts established after November 29.

## **VI. Comments to the Draft Decision**

The alternate draft decision of Commissioner Lynch was mailed to the parties in accordance with Pub. Util. Code § 311(g) and Rule 77.6 of the Commission's Rules of Practice and Procedure. Opening comments were filed by \_\_\_\_\_ and reply comments by \_\_\_\_\_.

**Findings of Fact**

1. Applying an earnings test to balancing accounts is not new.
2. The existing procedures for recovery of under and over collections in balancing accounts, which we suspended as of November 29, 2001, were originally established for the utilities to recover unanticipated increases in electricity costs between general rate cases, without the need to file an additional rate case application. The procedures also served the purpose of protecting shareholders from having to finance large unanticipated expenses until the next general rate case.
3. The existing procedures become problematic when they have the practical and widespread effect of enhancing many utilities' earnings above Commission-authorized rates of return.
4. This OIR required the utilities to state during which of the last five years they were over earning on an actual and weather normalized, or pro forma, basis. On an actual basis, over earnings exceeded undercollected balancing accounts by \$15,771,000, with over earnings listed as a little over \$42 million and undercollected balancing accounts listed as about \$26.5 million. On a weather normalized basis, over earnings were about \$15,826,000.
5. Another related problem with the existing procedures occurs when a utility fails to file general rate case applications every three years, yet continues to seek balancing account treatment beyond the rate case cycle, thus depriving the Commission of scrutiny over the assumptions used to determine the rate structure. When these assumptions become stale, the rate structure becomes skewed.

6. The original purpose of these balancing accounts was to allow the utilities to recover fluctuations in unanticipated expenses within the normal rate case cycle to prevent financial injury.

7. A utility that exceeds its authorized rate of return is not in financial peril.

8. The issue of how various risks affect a utility's rate of return involves an inquiry into all relevant circumstances, not just one specific factor.

9. One utility, CalAm, believed the existing balancing account procedure capped recovery at the utility's authorized rate of return, and operated its balancing accounts accordingly.

10. The revised procedures permit the utility to earn at least up to its authorized rate of return, and even more than the authorized rate of return through any means other than the collection of these balancing accounts.

### **Conclusions of Law**

1. The rulings in the March 11, 2002 Assigned Commissioner and Administrative Law Judge's Scoping Memo should be affirmed.

2. We revise our procedures for recovery of balancing accounts existing prior to November 29, 2001 as follows: (a) if a utility is within its rate case cycle and is not over earning, the utility shall recover its balancing account subject to reasonableness review; and (b) if a utility is either within or outside of its rate case cycle and is over earning, the utility's recovery of expenses from the balancing accounts will be reduced by the amount of the over earning, again subject to reasonableness review. The utility shall remove the amount of the over earning from the balancing account and shall amortize it below the line. Utilities shall use the existing pro forma means test to evaluate earnings of the first and second test year revenues only, and for subsequent years shall use the recorded rate of return means test. If a utility is outside of the rate case cycle but

is not over earning according to the above tests, then it shall recover as set forth in part (a) of this conclusion of law.

3. We adopt the detailed procedures for Class A water and sewer utilities to dispose of balancing account balances accrued before November 29, 2001, as set forth in Appendix B, as well as the example of the application of these procedures as set forth in Appendix C.

4. To qualify as an offsettable expense for balancing account treatment, the Commission must have approved the expense for balancing account tracking in a decision. A utility's advice letter requesting an offset rate increase should include the citation to the decision or other Commission document approving tracking of each type of expense requested, except for purchased power, purchased water, and pump tax expenses.

5. If the Commission authorized a change in base rates to offset the expense, the resulting offset revenues must be booked to the same balancing account.

6. Utilities should book each authorized offsettable expense and corresponding offset revenue (if any) to its own balancing account. Each district of a multi-district utility should keep its own set of balancing accounts. Balancing account balances existing after June 22, 1994 shall earn interest at the Commission-authorized rate.

7. Utilities requesting offset rate increases that are either (a) within their rate case cycle and over earning on a pro forma basis, or (b) outside of their rate case cycle have 90 days from the effective date of this decision to file advice letters requesting offsets pursuant to the policies and procedures set forth in this decision.

8. The readjustment of a utility's specific rate of return is not within the scope of this industry-wide proceeding. The appropriate forum for such a utility-

specific inquiry is a utility's general rate case or other appropriate proceeding the Commission may designate in the future.

9. The Commission has the discretion to modify the existing procedure when it is producing unintended results.

10. The revised procedures we adopt in this interim decision do not constitute retroactive ratemaking.

11. Because we wish to achieve closure regarding the balancing accounts existing prior to November 29, 2001, this interim order should be effective immediately.

### **INTERIM ORDER**

#### **IT IS ORDERED** that:

1. We adopt the procedures for Class A water and sewer utilities to dispose of balancing account balances accrued before November 29, 2001, as set forth in the text of this decision as well as Appendix B. We also adopt the example of the application of these procedures as set forth in Appendix C.

2. Utilities requesting offset rate increases that are either (a) within their rate case cycle and over earning on a pro forma basis, or (b) outside of their rate case cycle shall file, within 90 days from the effective date of this decision, advice letters requesting offsets pursuant to the policies and procedures set forth in this decision.

3. The rulings in the March 11, 2002 Assigned Commissioner and Administrative Law Judge's Scoping Memo should be affirmed.

This order is effective today.

Dated \_\_\_\_\_, at San Francisco, California.

# **APPENDIX A**



**Over Earnings by Utility for Years 1996-2000:  
RECORDED VALUES**

Cal Water	\$14,171,317
Suburban	2,679,974
So Cal	1,343,643
Park Water	339,006
Apple Valley	341,153
San Gabriel	1,881,343
San Jose	11,185,000
Cal Am	5,697,000
Citizens	859,000
Valencia	3,917,290
Alco <b>CLASS B</b>	13,513
County <b>CLASS B</b>	26,925
Del Oro <b>CLASS B</b>	247,994
<b>INDUSTRY TOTAL</b>	<b>42,566,993</b>

**Over Earnings by Utility for Years 1996-2000  
PRO FORMA VALUES\***

Cal Water	\$7,174,700
So Cal	910,723
San Jose	58,058
Cal Am	771,096
Citizens	447,617
Valencia	5,798,600
San Gabriel	154,223
Greak Oaks	510,833
<b>INDUSTRY TOTAL</b>	<b>15,825,827</b>

\*Class B utilities do not make this calculation.

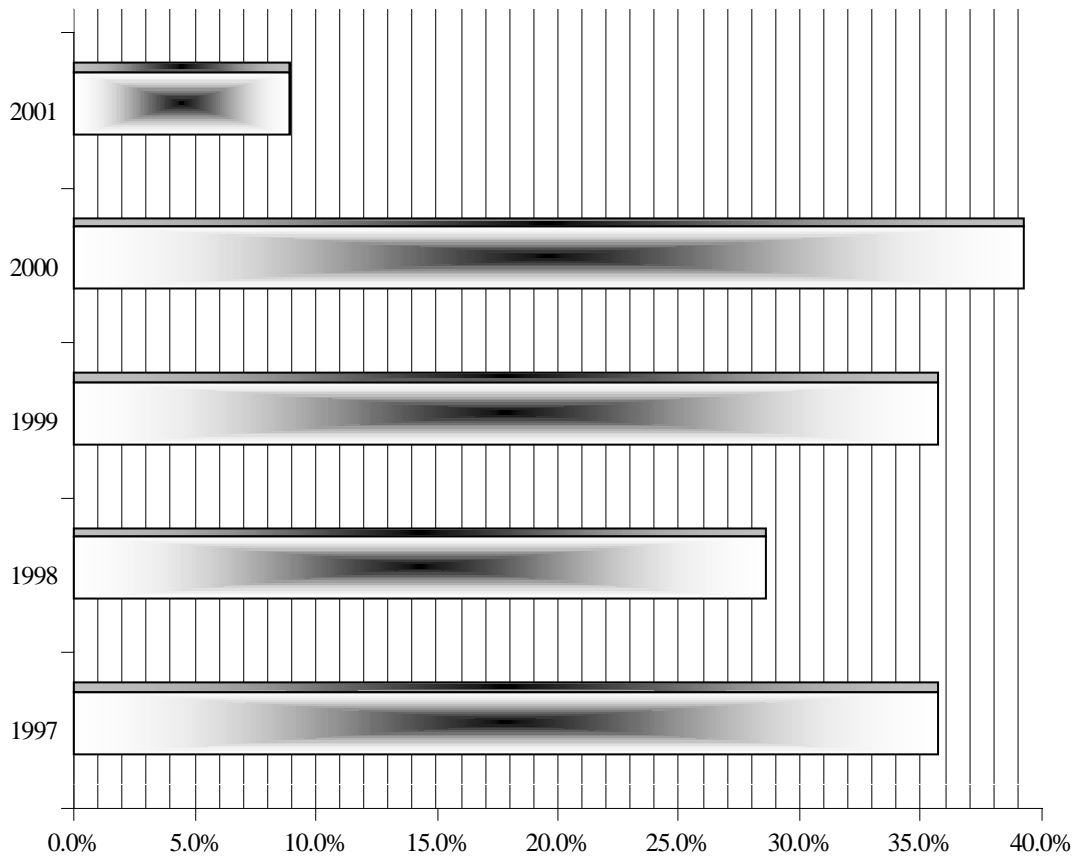
Percentage of Pro Forma Over Earnings  
**CALIFORNIA WATER SERVICE**

	<b>1997</b> %	<b>1998</b> %	<b>1999</b> %	<b>2000</b> %	<b>2001</b> %
Bakersfield	19.3	22.3	11.9	1.3	
Bear Gulch			8.1	12.7	
Chico	24.0	24.9	5.7	15.6	
Dixon	11.7	30.4	15.0	4.3	
East LA		7.	7.7		14.3
King City	37.7	45.1	28.7	21.3	
Livermore			1.2	8.4	
Los Altos			2.0		
Marysville			2.5	2.6	
Mid Peninsula	7.8	1.0	4.3		
Oroville				3.3	
Palos Verdes		28.8			
Salinas	15.8	14.5	8.5		
Selma		20.9			
South SF		4.9	0.3		
Stockton			5.5	7.7	
Visalia	5.1		1.1	7.7	
Willows	7.7			5.3	

**PERCENTAGE OF PRO FORMA OVER EARNINGS**  
**ALL UTILITIES OTHER THAN CAL WATER SERVICE**

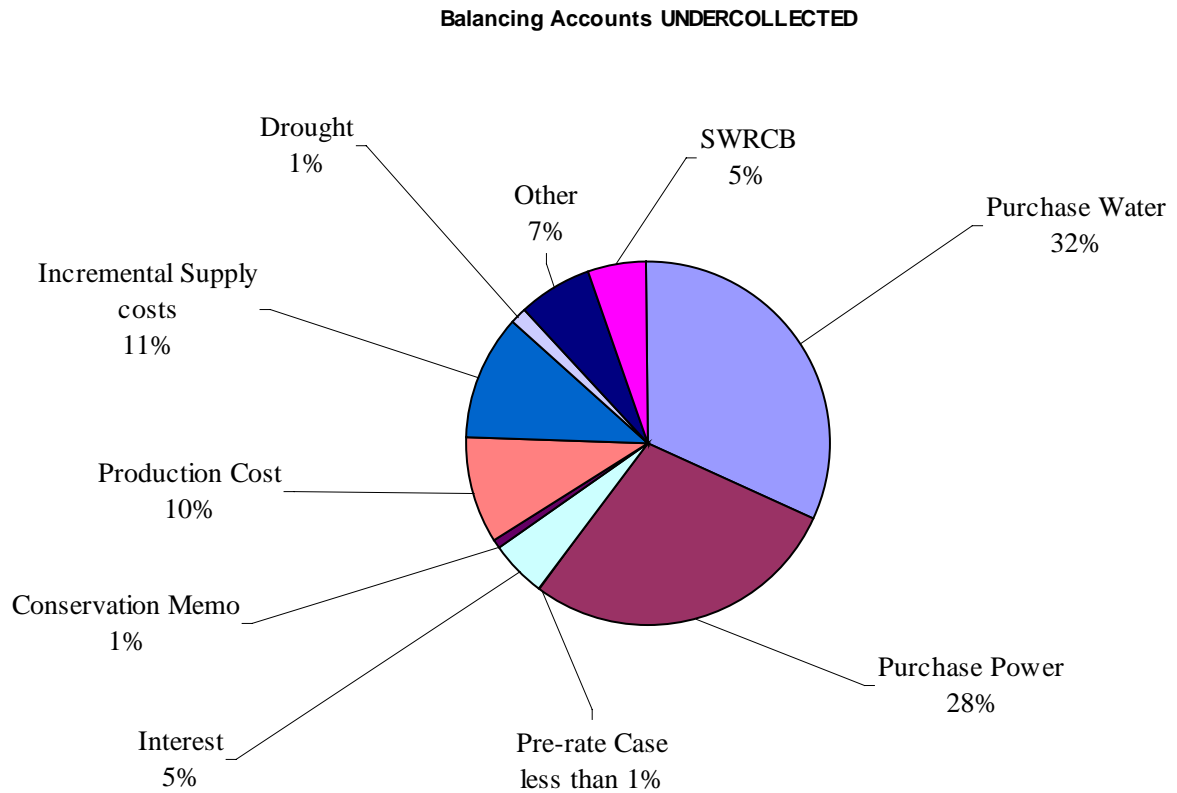
	1996 %	1997 %	1998 %	1999 %	2000 %
<b>Valencia</b>	<b>6.9</b>	<b>9.0</b>	<b>10.6</b>	<b>16.8</b>	<b>21.6</b>
<b>Citizens</b>	<b>1.3</b>		<b>0.2</b>	<b>0.4</b>	
<b>San Jose</b>		<b>0.1</b>			
<b>So Cal</b>	<b>0.1</b>				<b>0.2</b>
<b>San Gabriel: LA</b>		<b>0.6</b>			
<b>San Gabriel: Fontana</b>	<b>0.1</b>				
<b>San Jose</b>	<b>0.1</b>				
<b>Cal Am</b>		<b>0.6</b>		<b>0.3</b>	<b>0.5</b>

**Percentage of Over Earnings  
Across All Water Districts/Utilities  
1997-2001\*  
RECORDED VALUES**



**\*2001 figures are estimates Unaudited figures**

Undercollections per expense category.



<b>Purchase Water</b>	<b>\$8,509,932</b>
<b>Purchase Power</b>	<b>7,449,144</b>
<b>Pre-rate Case</b>	<b>17,224</b>
<b>Interest</b>	<b>1,305,213</b>
<b>Conservation Memo</b>	<b>231,714</b>
<b>Production Cost</b>	<b>2,556,009</b>
<b>Incremental Supply costs</b>	<b>2,992,256</b>
<b>Drought</b>	<b>368,128</b>
<b>Other</b>	<b>1,777,358</b>
<b>SWRCB</b>	<b>1,435,000</b>
<b>TOTAL</b>	<b><u>26,641,978</u></b>

Pump Tax is an industry-wide overcollected Balancing Account.

## **APPENDIX B**

**PROCEDURE FOR CLASS A WATER AND SEWER UTILITIES TO DISPOSE OF  
BALANCING ACCOUNT BALANCES ACCRUED BEFORE NOVEMBER 29, 2001****1. SCOPE**

The purpose of this procedure is to process the amortization of each of the district's balancing accounts with outstanding balances as of November 29, 2001<sup>17</sup>. Each account will be analyzed by each calendar year from the last authorized amortization of the account.

**2. WORKPAPERS**

For each calendar year submit the following:

- a. Balancing account calculations as illustrated in the June 1983 "Procedures for Maintaining Balancing Accounts for Water Utilities,"<sup>18</sup> Appendices 1, 2, and 3; adding annual totals to both the "Revenue" and "Expense" columns.
- b. Rate of return calculations as illustrated in the 1985 "Guidelines for Normal Rate Making Adjustments in Connection with the Calculation of a Weather Normalized Pro-Forma Rate of Return on Recorded Operations For Water Utilities" (Guidelines) and the 1995 "New Procedure For Filing Step Increase, Attrition and Offset Advice Letters" (Procedures), with pro-forma calculations for only the first and second general rate case test years and recorded calculations for all other years.

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<sup>17</sup> While R.01-12-009 suspended only purchased power, purchased water and pump tax balancing accounts, this procedure will apply to all outstanding balancing accounts.

<sup>18</sup> In accordance with D.94-06-033, balancing accounts shall accrue interest as of June 22, 1994. The rate to be applied is one-twelfth of the most recent month's interest on Commercial Paper (prime, three months), published in the Federal Reserve Statistical Release (FRSR), Table G.13, or its successor publication. In later versions of FRSR, Table G. 13 (since 1997) and in its successor, Table H.15, the rate referred to as "non-financial" should be used.

For each balancing account submit the following:

- a. The Commission document authorizing the account, except in the case of purchased power, purchased water and pump tax.
- b. A copy of the resolution or decision authorizing the last amortization of the balancing account.

### 3. AMOUNT OF OVER-EARNINGS

To determine disposition of the balancing accounts it is necessary to determine whether the district over-earned (i.e. exceeded the company's last authorized rate of return) in each calendar year. The authorized rate of return will be compared with the pro-forma rate of return and recorded rate of return in the following manner.

- a. In the first and second general rate case test years, the pro-forma rate of return will be used.
- b. For all other years, the recorded rate of return will be calculated in the same way as illustrated in the Guidelines and Procedures. However, the revenue and expense components used in calculations of the recorded rate of return will be adjusted in the following manner.
  - 1) Calculate total recorded revenue excluding the individually identified total of (a) surcharge, (b) surcredit, and (c) rate changes reflected in balancing account revenues (increases or decreases).
  - 2) Calculate total recorded allowable expenses minus the individually identified total of balancing account expense components.
  - 3) If the pro-forma rate of return or recorded rate of return calculated in 3.a. and 3.b. exceeds the authorized rate of return, then the district has over earned. The dollar amount of over-earnings is calculated by multiplying the difference between the pro-forma or the recorded rate of return and the authorized rate of return by the recorded weighted average rate base.

IF THERE HAS BEEN NO OVER EARNING IN ANY CALENDAR YEAR,  
PROCEED TO DIRECTION NUMBER 5.

IF THERE HAS BEEN OVEREARNING IN ANY CALENDAR YEAR, PROCEED  
WITH THE ADJUSTMENT CALCULATION BELOW.

### 4. ADJUSTMENT CALCULATION

Determine the balancing account adjustment as follows:

- a. For each year in which there was over-earning sum all expense components from all balancing accounts, excluding interest.

- b. For each year in which there was over-earning record as the annual adjustment amount, either the sum of the expense components or the amount of over earning, whichever is less.
- c. In a separate account distribute 1/12 of each annual adjustment amount to the months of their respective years in the same manner as if they were balancing account revenues. (Book a zero to each month of the years without over-earning.)
- d. Treat these monthly balances as if they had been booked to the account continuously throughout the entire period and apply interest to the monthly accrual at the 90-day commercial paper rate<sup>19</sup> reported for that month.
- e. Combine the accrual from 4.d. with balancing account accruals in step 5.

5. SURCHARGE OR REFUND

Combine the accruals from all balancing accounts (up to the date of filing) with any amount calculated in 4.e. and dispose of as follows:

- a. Request recovery of a net under-collection in the balancing account(s) by amortizing the under-collection and applying a surcharge to the quantity rates.
- b. Request refunding of a net over-collection to the customers by amortizing the over-collection and crediting the service charge of all customers, based on the meter equivalent size of the service connection, for such period of time needed to refund the amount of the over-collection.

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<sup>19</sup> As defined above.



## **APPENDIX C**

**BALANCING ACCOUNT EXAMPLE**

The most recent GRC of the Smallville district of Regulated Water Company (RWC) was in 1998, with test years of 1999 and 2000.

Smallville experienced an increase in power costs in March of 1999 and began tracking them in a balancing account. They were granted an offset rate increase in April of 1999. Subsequently, there were addition increases in power cost and addition offsets were approved.

Smallville experienced an increase in purchased water costs in July of 2000 and began tracking them in a separate balancing account. They were granted an offset rate increase in September of 2000.

RWC is filing to amortize Smallville's balancing accounts on October 1, 2002.

Step 3.a&c: RWC determines that Smallville district had pro-forma over-earnings of \$36,000 in 1999, but did not over-earn in 2000 on a pro-forma basis.

Step 3.b&c: Over-earning of \$145,700 is calculated for 2001 using the recorded rate of return calculation as modified in the procedure (p. 6).

Step 4.a: For 1999 there is only the purchased power account, which has an expense component of \$49,713 (p. 2). For 2001, the purchased power expense component is \$81,023 (p.3) and the purchased water expense component is \$51,958 (p.4), for a total of \$132,981.

Step 4.b: For 1999 the over-earning amount is \$36,000, which is less than the total expense component of \$49,713. \$36,000 is recorded as the adjustment amount in 1999. For 2001 the over-earning amount is \$147,500. The total expense component of \$132,981 is less than \$145,700, so \$132,981 is recorded as the annual adjustment amount.

Step 4.c: In a new and separate account (p. 5), \$36,000/12 is booked to each month of 1999 and \$132,981/12 is booked to each month of 2001. (Zero is booked to each month of 2000.)

Step 4.d: Historic values for the commercial paper rate are obtained from the Federal Reserve's web site (<http://www.federalreserve.gov/releases/h15/data/m/cp3m.txt>). Interest is applied to the monthly accruals in the adjustment account (p. 5).

Step 4.e: The \$177,843 (p.5) over-collected account will be combined with balancing accounts in step 5.

Step 5: The accruals for purchased power of a \$24,118 (p.3) under-collection and for purchased water of a \$7,049 (p.4) under-collection are combined with the \$177,843 (p. 5) balance in the adjustment account to arrive at a \$146,676 over-collected balance. This over-collection is to be refunded on the service charge as per step 5.b.

**BALANCING ACCOUNT EXAMPLE**

## 1999 Purchased Power

Month	Recorded Sales (KCcf)	Recorded Power Consumption (Kwh)	Incremental Expense Rate Change (\$/Kwh)	Incremental Revenue Rate Change (\$/Ccf)	Revenue Component (\$)	Expense Component (\$)	Over or (Under) Collection (\$)	Commercial Paper Rate (%)	Interest (\$)	Accrual (\$)
Jan	240.2	168,600	-	-	-	-	-	4.77	-	-
Feb	237.3	165,600	-	-	-	-	-	4.79	-	-
Mar	234.2	162,400	0.015	-	-	2,436	(2,436)	4.81	-	(2,436)
Apr	247.2	178,400	0.015	0.0111	2,744	2,676	68	4.79	(10)	(2,378)
May	328.6	231,000	0.015	0.0111	3,647	3,465	182	4.81	(10)	(2,205)
Jun	328.4	235,000	0.025	0.0111	3,645	5,875	(2,230)	4.98	(9)	(4,444)
Jul	349.3	242,200	0.025	0.0111	3,877	6,055	(2,178)	5.11	(19)	(6,640)
Aug	342.8	247,000	0.025	0.0193	6,616	6,175	441	5.25	(29)	(6,228)
Sep	333.2	231,100	0.030	0.0193	6,431	6,933	(502)	5.32	(28)	(6,758)
Oct	298.0	206,600	0.030	0.0193	5,751	6,198	(447)	5.88	(33)	(7,238)
Nov	247.3	180,000	0.030	0.0193	4,773	5,400	(627)	5.81	(35)	(7,900)
Dec	207.6	150,000	0.030	0.0193	4,007	4,500	(493)	5.87	(39)	(8,432)
Total Revenue Component					41,492					
Total Expense Comp						49,713				

## 2000 Purchased Power

Month	Recorded Sales (KCcf)	Recorded Power Consumption (Kwh)	Incremental Expense Rate Change (\$/Kwh)	Incremental Revenue Rate Change (\$/Ccf)	Revenue Component (\$)	Expense Component (\$)	Over or (Under) Collection (\$)	Commercial Paper Rate (%)	Interest (\$)	Accrual (\$)
Jan	218.6	158,700	0.030	0.0193	4,219	4,761	(542)	5.74	(40)	(9,015)
Feb	215.3	156,300	0.030	0.0193	4,155	4,689	(534)	5.87	(44)	(9,592)
Mar	237.6	172,500	0.030	0.0193	4,586	5,175	(589)	6.00	(48)	(10,230)
Apr	251.8	182,800	0.030	0.0193	4,860	5,484	(624)	6.11	(52)	(10,906)
May	305.2	221,600	0.030	0.0193	5,890	6,648	(758)	6.54	(59)	(11,723)
Jun	319.6	232,000	0.030	0.0193	6,168	6,960	(792)	6.57	(64)	(12,579)
Jul	340.0	246,900	0.030	0.0193	6,562	7,407	(845)	6.52	(68)	(13,492)
Aug	342.8	249,900	0.030	0.0193	6,616	7,497	(881)	6.49	(73)	(14,446)
Sep	328.8	238,800	0.030	0.0193	6,346	7,164	(818)	6.47	(78)	(15,342)
Oct	296.0	214,900	0.030	0.0193	5,713	6,447	(734)	6.51	(83)	(16,160)
Nov	241.3	175,000	0.030	0.0193	4,657	5,250	(593)	6.50	(88)	(16,840)
Dec	205.2	149,100	0.030	0.0193	3,960	4,473	(513)	6.34	(89)	(17,442)
Total Revenue Component					63,732					
Total Expense Component						71,955				

**BALANCING ACCOUNT EXAMPLE**

2001 Purchased Power (Through Nov. 29)

Month	Recorded Sales (KCcf)	Recorded Power Consumption (Kwh)	Incremental Expense Rate Change (\$/Kwh)	Incremental Revenue Rate Change (\$/Ccf)	Revenue Component (\$)	Expense Component (\$)	Over or (Under) Collection (\$)	Commercial Paper Rate (%)	Interest (\$)	Accrual (\$)
										(17,442)
Jan	218.6	158,700	0.030	0.0193	4,219	4,761	(542)	5.49	(80)	(18,064)
Feb	215.3	156,300	0.030	0.0193	4,155	4,689	(534)	5.14	(77)	(18,675)
Mar	237.6	172,500	0.037	0.0193	4,586	6,383	(1,797)	4.78	(74)	(20,546)
Apr	251.8	182,800	0.037	0.0193	4,860	6,764	(1,904)	4.44	(76)	(22,526)
May	305.2	221,600	0.037	0.0265	8,088	8,199	(111)	3.93	(74)	(22,711)
Jun	319.6	232,000	0.037	0.0265	8,469	8,584	(115)	3.67	(69)	(22,895)
Jul	340.0	246,900	0.037	0.0265	9,010	9,135	(125)	3.59	(68)	(23,089)
Aug	342.8	249,900	0.037	0.0265	9,084	9,246	(162)	3.42	(66)	(23,317)
Sep	328.8	238,800	0.037	0.0265	8,713	8,836	(122)	2.81	(55)	(23,494)
Oct	296.0	214,900	0.037	0.0265	7,844	7,951	(107)	2.28	(45)	(23,646)
Nov	241.3	175,000	0.037	0.0265	6,394	6,475	(81)	1.97	(39)	(23,765)
Dec					-	-		1.78	(35)	(23,800)
Total Revenue Component					75,423					
Total Expense Comp						81,023				

2002 Purchased Power Interest

Month	Commercial Paper Rate (%)	Interest (\$)	Accrual (\$)
			(23,800)
Jan	1.70	(34)	(23,834)
Feb	1.79	(36)	(23,869)
Mar	1.86	(37)	(23,906)
Apr	1.81	(36)	(23,943)
May	1.78	(36)	(23,978)
Jun	1.76	(35)	(24,013)
Jul	1.75	(35)	(24,048)
Aug*	1.75	(35)	(24,083)
Sep*	1.75	(35)	(24,118)

\*Interest Rate Estimated

**BALANCING ACCOUNT EXAMPLE**

## 2000 Purchased Water

Month	Recorded Sales (KCcf)	Recorded Water Production (AF)	Recorded Purchased Water (AF)	Incremental Expense Rate Change (\$/AF)	Incremental Revenue Rate Change (\$/Ccf)	Revenue Component (\$)	Expense Component (\$)	Over or (Under) Collection (\$)	Commercial Paper Rate (%)	Interest (\$)	Accrual (\$)
Jan	218.6	545.5	183.4	-	-	-	-	-	5.74	-	-
Feb	215.3	537.2	180.6	-	-	-	-	-	5.87	-	-
Mar	237.6	592.9	199.3	-	-	-	-	-	6.00	-	-
Apr	251.8	628.3	211.2	-	-	-	-	-	6.11	-	-
May	305.2	761.6	256.0	-	-	-	-	-	6.54	-	-
Jun	319.6	797.5	268.1	-	-	-	-	-	6.57	-	-
Jul	340.0	848.4	285.2	20.00	-	-	5,704	(5,704)	6.52	-	(5,704)
Aug	342.8	855.4	287.6	20.00	-	-	5,751	(5,751)	6.49	(31)	(11,486)
Sep	328.8	820.5	275.8	20.00	0.0180	5,918	5,516	402	6.47	(62)	(11,146)
Oct	296.0	738.6	248.3	20.00	0.0180	5,328	4,966	362	6.51	(60)	(10,844)
Nov	241.3	602.1	202.4	20.00	0.0180	4,343	4,048	295	6.50	(59)	(10,608)
Dec	205.2	512.0	172.1	20.00	0.0180	3,694	3,443	251	6.34	(56)	(10,413)
Total Revenue Component						19,283					
Total Expense Comp							29,428				

## 2001 Purchased Water (Through Nov. 29)

Month	Recorded Sales (KCcf)	Recorded Water Production (AF)	Recorded Purchased Water (AF)	Incremental Expense Rate Change (\$/AF)	Incremental Revenue Rate Change (\$/KCcf)	Revenue Component (\$)	Expense Component (\$)	Over or (Under) Collection (\$)	Commercial Paper Rate (%)	Interest (\$)	Accrual (\$)
Jan	218.6	545.5	183.4	20.00	0.0180	3,935	3,667	267	5.49	(48)	(10,193)
Feb	215.3	537.2	180.6	20.00	0.0180	3,875	3,612	263	5.14	(44)	(9,974)
Mar	237.6	592.9	199.3	20.00	0.0180	4,277	3,986	291	4.78	(40)	(9,723)
Apr	251.8	628.3	211.2	20.00	0.0180	4,532	4,224	308	4.44	(36)	(9,451)
May	305.2	761.6	256.0	20.00	0.0180	5,494	5,120	373	3.93	(31)	(9,108)
Jun	319.6	797.5	268.1	20.00	0.0180	5,753	5,362	391	3.67	(28)	(8,745)
Jul	340.0	848.4	285.2	20.00	0.0180	6,120	5,704	416	3.59	(26)	(8,355)
Aug	342.8	855.4	287.6	20.00	0.0180	6,170	5,751	419	3.42	(24)	(7,960)
Sep	328.8	820.5	275.8	20.00	0.0180	5,918	5,516	402	2.81	(19)	(7,576)
Oct	296.0	738.6	248.3	20.00	0.0180	5,328	4,966	362	2.28	(14)	(7,229)
Nov	241.3	602.1	202.4	20.00	0.0180	4,343	4,048	295	1.97	(12)	(6,946)
Total Revenue Component						55,746					
Total Expense Comp							51,958				

## 2002 Purchased Water Interest

Month	Commercial Paper Rate (%)	Interest (\$)	Accrual (\$)
			(6,956)
Jan	1.70	(10)	(6,966)
Feb	1.79	(10)	(6,976)
Mar	1.86	(11)	(6,987)
Apr	1.81	(11)	(6,997)
May	1.78	(10)	(7,008)
Jun	1.76	(10)	(7,018)
Jul	1.75	(10)	(7,028)
Aug*	1.75	(10)	(7,039)
Sep*	1.75	(10)	(7,049)

\*Interest Rate Estimated

Adjustment Account

**BALANCING ACCOUNT EXAMPLE**

Month	Adjustment (\$)	Commercial Paper Rate (%)	Interest (\$)	Accrual (\$)	Month	Adjustment (\$)	Commercial Paper Rate (%)	Interest (\$)	Accrual (\$)
Jan-99	3,000	4.77	-	3,000	Jan-01	11,082	5.49	180	50,567
Feb-99	3,000	4.79	12	6,012	Feb-01	11,082	5.14	217	61,865
Mar-99	3,000	4.81	24	9,036	Mar-01	11,082	4.78	246	73,193
Apr-99	3,000	4.79	36	12,072	Apr-01	11,082	4.44	271	84,546
May-99	3,000	4.81	48	15,121	May-01	11,082	3.93	277	95,904
Jun-99	3,000	4.98	63	18,183	Jun-01	11,082	3.67	293	107,279
Jul-99	3,000	5.11	77	21,261	Jul-01	11,082	3.59	321	118,682
Aug-99	3,000	5.25	93	24,354	Aug-01	11,082	3.42	338	130,102
Sep-99	3,000	5.32	108	27,462	Sep-01	11,082	2.81	305	141,488
Oct-99	3,000	5.88	135	30,596	Oct-01	11,082	2.28	269	152,839
Nov-99	3,000	5.81	148	33,744	Nov-01	11,082	1.97	251	164,172
Dec-99	3,000	5.87	165	36,909	Dec-01	11,082	1.78	244	175,497

Month	Adjustment (\$)	Commercial Paper Rate (%)	Interest (\$)	Accrual (\$)	Month	Adjustment (\$)	Commercial Paper Rate (%)	Interest (\$)	Accrual (\$)
Jan-00	-	5.74	177	37,086	Jan-02		1.70	249	175,746
Feb-00	-	5.87	181	37,267	Feb-02		1.79	262	176,008
Mar-00	-	6.00	186	37,454	Mar-02		1.86	273	176,281
Apr-00	-	6.11	191	37,644	Apr-02		1.81	266	176,546
May-00	-	6.54	205	37,850	May-02		1.78	262	176,808
Jun-00	-	6.57	207	38,057	Jun-02		1.76	259	177,068
Jul-00	-	6.52	207	38,264	Jul-02		1.75	258	177,326
Aug-00	-	6.49	207	38,471	Aug-02*		1.75	259	177,584
Sep-00	-	6.47	207	38,678	Sep-02*		1.75	259	177,843
Oct-00	-	6.51	210	38,888					
Nov-00	-	6.50	211	39,098					
Dec-00	-	6.34	207	39,305					

\*Interest Rate Estimated

**BALANCING ACCOUNT EXAMPLE****SUMMARY OF EARNINGS**

Dollars in Thousands

	Decision 98-00-000	2001 Recorded	2001 Recorded with Adjustments
<b>OPERATING REVENUES</b>			
Metered Revenues	2,209.0	2,509.3	2,509.3
Fire Service	20.5	20.9	20.9
Other	6.2	6.0	6.0
<b>Adjustments:</b>			
<b>Purchased Power Surcharge</b>			-75.4
<b>Purchased Water Surcharge</b>			-55.7
<b>Tank Painting Amortization</b>			-12.2
Total	2,235.7	2,536.2	2,392.9
<b>OPERATING EXPENSES</b>			
Purchased Water	408.2	439.2	439.2
Purchased Power	319.1	331.2	331.2
Chemicals	15.2	16.3	16.3
Payroll	307.5	301.2	301.2
Uncollectibles	8.2	8.6	8.6
Other O&M	155.2	161.0	161.0
Other A&G, & Misc	231.8	229.1	229.1
<b>Adjustments:</b>			
<b>Pur Power Exp Component</b>			-81.0
<b>Pur Water Exp Component</b>			-52.0
Subtotal	1,445.2	1,486.6	1,353.6
General Office Allocation	206.5	212.5	212.5
Total O & M Expenses	1,651.7	1,699.1	1,566.1
Depreciation	161.2	168.9	168.9
Ad Valorem Taxes	42.5	43.0	43.0
Payroll Taxes	34.2	33.9	33.9
Other Taxes and Fees	21.3	22.5	22.5
Subtotal	259.2	268.3	268.3
Total Operating Expenses	1,910.9	1,967.4	1,834.4
Net Revenues Before Income Tax	324.8	568.8	558.5
State Income Tax	15.6	27.3	26.8
Federal Income Tax	100.7	176.3	173.1
Total Income Tax	116.3	203.6	199.9
NET OPERATING REVENUE	208.5	365.2	358.6
RATE BASE	2,342.7	2,392.0	2,392.0
<b>RATE OF RETURN:</b>			
Authorized	8.90%		
Recorded		15.27%	14.99%

Over-earning is 14.99%-8.90%=6.09%. The dollar amount of over-earning is  
6.09% x \$2,392,000 = \$145,700.